

Approved For Release 2010/07/22 : CIA-RDP80B01676R000200140013-3  
SUBJECT: The Probable Effectiveness of  
Measures to Curb the Balance of Payments Deficit

63-6962  
63 Oct 9 1963

Noted by  
Dci 9-9-63

1. This memorandum is for your information, and concerns the President's message to Congress of 18 July which transmitted a program for correcting the U.S. balance of payments deficit. The Administration has estimated that the enactment of the proposed measures and cuts in U.S. Government expenditures abroad would lead to a substantial improvement in U.S. international payments -- on the order of a \$2 billion decrease in the U.S. deficit by 1965; the current total deficit, judging from the first quarter of 1963, is running at about \$2.8 billion this year. This forecast appears to us in ORR to be optimistic, particularly now that Canada is excluded from the provisions of the security purchase tax.

2. The key measures, in addition to the move to curtail federal expenditures abroad, are the proposed interest-equalization tax on U.S. purchases of foreign securities, the announcement of standby arrangements with the International Monetary Fund (IMF) authorizing U.S. withdrawals from the fund of \$500 million during the next year, and the increase in the Federal Reserve rediscount rate on commercial paper. The arrangements with the IMF permit the Fund to continue to increase its dollar holdings and thus help to finance the U.S. deficit. This is an interim step, which is effective in the short-run while other corrective measures are (hopefully) operating to eliminate the deficit. This measure is a technical one to avoid what would otherwise amount to a contraction in the world's willingness to hold dollars. By itself it does nothing to remedy the cause of the increasing supply of dollars available to the rest of the world.

3. The President's security purchase tax proposal is intended to retard that part of the outflow of U.S. capital which is for the purchase of foreign securities. This flow, over the past few years, is summarized as follows:

Millions of dollars

	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>1963</u> (1st qtr.)
U.S. purchase of new foreign issues	573	523	1,076	512
U.S. purchases of outstanding issues	<u>177</u>	<u>353</u>	<u>55</u>	<u>26</u>
Total U.S. purchases of foreign securities	<u>750</u>	<u>876</u>	<u>1,131</u>	<u>538</u>
From Western Europe	133	266	195	84
From Canada	241	327	379	316
All others	376	283	557	138

4. The leading foreign borrowers in New York are Canada, the World Bank and Israel; none of these countries' securities would be subject to the proposed tax. Since the beginning of 1960, 45 percent of total U.S. purchases of foreign securities have come from Canada and a bare 20 percent from Western Europe on whose securities the burden of the tax would fall. Thus, the Administration's estimate that the proposed tax would reduce U.S. purchases of foreign securities by more than 50 percent seems unduly optimistic.

5. Just prior to the President's message, the Board of Governors of the Federal Reserve System announced an increase from three to three and one-half percent in the rate at which the Federal Reserve Banks will rediscount commercial paper and other acceptable assets. Since this rate represents the cost of short-term accommodation to commercial banks, it is the fundamental determinant of the entire structure of U.S. interest rates. Because historically a shift in the interest-differential between New York and London in favor of New York has been associated with a net movement of short-term funds into New York (and vice versa), it is to be expected that the higher level of U.S. interest rates resulting from the recent Federal Reserve action will curb the outflow of U.S. short-term capital abroad. Implicit in the President's message is the estimate that the increase in short-term interest rates would result in a \$500 million decline in the short-term capital flow. Whether the present interest-differential will be large enough to accomplish this decline remains to be seen; but because short-term capital flows have been so sizeable of late (an average annual outflow of \$2 billion in 1960-62) interest rate adjustment appears to be a potent tool.